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In the Supreme Court of the United States

Carole Keeton Rylander, Comptroller of
Public Accounts of the State of Texas, and
John Cornyn, Attorney General of the State of Texas,
Petitioners,

v.

The Dow Chemical Company,
Respondent.

On Petition for Writ of Certiorari to
the Third Court of Appeals of Texas

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

(1) May a State, consistently with the Due Process Clause and the McCarran-Ferguson Act, tax a corporation doing business in the State on the localized value of insurance procured by it to cover its risks located in the State without regard to connections between its insurers and the taxing State?

(2) Should the Court explicitly overrule its decision in *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451 (1962)?

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No. _____

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PETITION FOR A WRIT OF CERTIORARI

Relying explicitly and solely on this Court's decision in *State Board of Insurance v. Todd Shipyards Corp.*, the Texas Third Court of Appeals held that a corporation may have millions of dollars in property and business activities within a State and yet pay no tax on the insurance it purchases to cover its risks of loss within that State. It matters not that the State provides a full range of benefits and protections to those business interests on a daily basis. Provided the corporation takes its insurance negotiations and payments out of State—activities that have little or no connection to the value of the insurance itself—the corporation pays no tax on the insurance in that State or, most likely, in any other.

The scope of State authority to regulate and tax the business of insurance is an issue of great importance to all States. More than two-thirds of the States tax independently procured insurance. In the McCarran-Ferguson Act, Congress ceded broad authority to the States to regulate and tax the business of insurance subject only to constitutional limitations, such as the Due Process Clause, and to federal legislation that specifically relates to the business of insurance. *Todd Shipyards* and the decision in this case are at odds with this Court's Due Process jurisprudence and with its more recent decisions construing the McCarran-Ferguson Act. State courts are conflicted and uncertain about *Todd Shipyards*' current validity and even its analytical basis.

If the decision below properly interprets the law, then: (1) States will lose tax revenue; (2) corporate insureds will have an incentive to move their insurance coverage offshore, adversely and unfairly affecting the States' licensed insurance markets; and (3) regulatory authorities will see their recent efforts to establish a more rational nationwide allocation system for insurance taxes thwarted by the resurrection of a doctrine with no sound constitutional or statutory underpinnings. *See* National Association of Insurance Commissioners (NAIC) Model Regulation V-872-1, Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risks (1996) *and* Robert M. Mangino, et al. *Recent Developments in Excess Insurance, Surplus Lines Insurance, and Reinsurance Law*, 36 Tort & Ins. L.J. 309, 317 (Winter 2001).

Petitioners Carole Keeton Rylander, Comptroller of Public Accounts of the State of Texas, and John Cornyn, Attorney General of the State of Texas (the State), respectfully ask the Court to grant a writ of certiorari to review the court of appeals' judgment. Only this Court can resolve these important issues regarding federal limitations on the States' authority to tax the business of insurance.

OPINIONS BELOW

The Texas Third Court of Appeals' opinion is published at 38 S.W.3d 741 and is reprinted in the appendix at A2-12. The Texas Supreme Court denied the State's Petition for Review on June 7, 2001. The order is noted at 44 Tex. S.Ct.J. 797 (June 9, 2001) and is reprinted in the appendix at A13-14.

STATEMENT ON JURISDICTION

The Court has jurisdiction to review this case under 28 U.S.C. §1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. CONST. amend. XIV §1

No State shall ... deprive any person of life, liberty, or property without due process of law.

McCarran-Ferguson Act

15 U.S.C. §1011

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. §1012(a)

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

15 U.S.C. §1012(b)

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

TEX. INS. CODE §101.252(a), (b)[1]

Except as provided by Subsection (f), an insured who procures insurance in accordance with Section 101.053(b)(4), or another person designated by the insured, shall:

(1) file a report with the comptroller; and

(2) pay an independently procured insurance tax of 4.85 percent.

(b) If a policy covers risks or exposures only partially located in this state, the tax payable is computed on the portion of the premium that is properly allocated to a risk or exposure located in this state.

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[1] Sections 101.252 and 101.053 are derived from former TEX. INS. CODE art. 1.14-1 §12, which was in effect during the period in issue and which was recodified with only minor changes not pertinent to this dispute. *See* Act of May 12, 1967, 60th Leg., R.S., ch. 185, §1, *amended by* Act of May 18, 1995, 74th Leg., R.S., ch. 279, §1, *repealed by* Act of April 23, 1999, 76th Leg., R.S. ch.101, §5.

(f) This section does not apply to premiums for individual life or individual disability insurance.

TEX. INS. CODE §101.053(b)(4)

(b) Sections 101.051 and 101.052[2] do not apply to:

(4) a transaction:

(A) that involves an insurance contract independently procured through negotiations occurring entirely outside this state;

(B) that is reported; and

(C) on which premium tax is paid in accordance with this chapter.

STATEMENT OF THE CASE

The Dow Chemical Company is a major corporation doing substantial business in Texas and in many locations throughout the world. Dow Chemical purchased various insurance policies to cover hundreds of millions of dollars of risks in Texas and elsewhere. State's motion for summary judgment excerpts, App. B18, 27, 44, 46. With some exclusions, the policies covered primary or excess liability for a wide variety of losses. The insured risks include personal injury, pollution, property damage, water damage, payroll, defective products and advertising. *Id.* at B25, 38, 48-49, 63-67 Some policies covered Dow Chemical's employees and their property, as well as the property of other persons on Dow Chemical's premises. *Id.* at B49. Dow Chemical admits that it does business in Texas and does not contest the amount of premiums allocated to Texas. *Id.* at B6-7.

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[2] These sections define acts which subject the insurance to State regulation. Independently procured insurance is thus exempted from regulations or sanctions that might otherwise apply.

Some policies provided that Dow Chemical's insurers could inspect its property, participate in the investigation and defense of claims, appeal adverse judgments, and use local courts for some purposes. There is, however, no evidence that Dow Chemical's insurers or their agents ever were licensed or present in Texas, or that any payments or correspondence were made to or from Texas regarding the policies. The insurance was negotiated and paid for through Dow Chemical's corporate headquarters in Michigan. *Id.* at B8-17. The insurance was placed through Marsh (Dow Chemical's insurance broker, with offices in Michigan and Bermuda) with insurers in Bermuda or was written directly by Dow Chemical's insurance subsidiaries, Dorintal and Timber. *Id.*

The State levied independently procured insurance tax against Dow Chemical for the premiums paid to cover its risks in Texas for the period from January 1, 1991 through December 31, 1997. TEX. INS. CODE §101.252. Dow Chemical paid the tax under protest, contending that the State lacked authority to impose the tax in view of *Todd Shipyards*. Dow Chemical's motion for summary judgment, App. C1-5. Dow Chemical contended that *Todd Shipyards* construed the McCarran-Ferguson Act, but that the district court was required to follow the direct Supreme Court precedent in any event. *Id.* The State contended that *Todd Shipyards* was a Due Process case, expressly following older decisions under the rule of *stare decisis*, that had been overruled by *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). State's motion, App. at B3-4. The State also contended that Dow Chemical's insurance had sufficient contacts with Texas to justify the tax under Due Process even if *Todd Shipyards* were still good law. *Id.* at B2-3. The State has openly and consistently administered the independently procured insurance tax as it was applied in this case over a long period of time. *Id.* at B73-75. The State has collected several million dollars annually and collected $7,351,436 from 2537 different taxpayers in 1998. *Id.*

The district court granted the State's motion and denied Dow Chemical's motion without opinion. App. at A15-16. The court of appeals reversed and rendered judgment as a matter of law for Dow Chemical, concluding that *Todd Shipyards* controlled the case and that the independently procured insurance tax violated the McCarran-Ferguson Act. *Dow Chemical Co. v. Rylander*, 38 S.W.3d 741, 744-45 (Tex. App.—Austin 2001, pet. denied); App. at A2-12. The court of appeals, feeling bound by *Todd Shipyards*, declined to consider developments in the law of Due Process or other cases construing the McCarran-Ferguson Act over the last forty years. Id. The Texas Supreme Court denied review of that judgment. *Id.*; 44 Tex. S.Ct.J. 797 (June 9, 2001). App. at A13-14.

REASONS FOR GRANTING THE WRIT

In denying the State's authority to tax the localized value of insurance for a corporation doing business in the State, the court of appeals perpetuated an anomaly in Due Process law and in the construction of the McCarran-Ferguson Act. Due Process in taxation requires: (1) that a State provide some benefit or protection justifying the tax, (2) that the State have nexus or some minimal connection with the person or thing subject to tax, and (3) that the values subjected to tax be rationally connected to the taxing State. All of these elements are easily identified in this case. Texas provides many benefits and protections to Dow Chemical. It has a nexus with Dow Chemical and with the subjects of its insurance. The premiums Dow Chemical paid to insure Texas risks rationally measure the local value of that insurance. The tax here is functionally similar to a use tax, taxing a purchaser on localized value even if the sales transaction itself may occur outside the State's jurisdiction. A State may tax intangible values when they may be fairly allocated to that State.

The McCarran-Ferguson Act put the full weight of Congress' authority behind the continued regulation and taxation

of the business of insurance by the several States. Congress intended, and this Court has held, that the Act created a special anti-preemption rule to avoid inadvertent federal interference with State authority over the business of insurance. The plain language of the Act contains no limit on that authority. Letting the perceived whispers of inconclusive legislative history overcome the plain language of the Act, as the court of appeals has done by continuing to follow *Todd Shipyards*, turns the Act into an oxymoron of the highest order and frustrates Congressional intent.

Todd Shipyards should be explicitly overruled. It is an anomaly with no real support in the constitutional law of Due Process or in the McCarran-Ferguson Act. *Todd Shipyards* affirmed the Texas courts that followed earlier Due Process decisions of this Court.[3] *See State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451 (1962), *aff'g State Bd. of Ins. v. Todd Shipyards Corp.*, 340 S.W.2d 339 (Tex. Civ. App.—Austin 1960) *writ ref'd n.r.e.* 343 S.W.2d 241 (Tex. 1961) (per curiam). It invalidated the independently procured insurance tax where the location of the insured risk was the only connection between the taxing State and the insurer or its insurance contracts. *Id.*, 370 U.S. at 454-55, 458. *Todd Shipyards*, however, approached the issues in the case not only as a part of the Court's ongoing analysis and application of Due Process principles, but also as a part of "the design that Congress fashioned" in the McCarran-Ferguson Act. *Todd Shipyards*, 370 U.S. at 458. In taking an uncertain middle ground between a Due Process analysis of the taxability of an insured and the statutory construction of the McCarran-Ferguson Act as applied to State taxation, the *Todd Shipyards* Court

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[3] "We are of the opinion that the decision in this case is controlled by *Allgeyer v. State of Louisiana*, 165 U.S. 578 and *St. Louis Cotton Compress Company v. State of Arkansas*, 260 U.S. 346." *State Bd. of Ins. v. Todd Shipyards Corp.*, 343 S.W. 2d 241, 242 (Tex. 1961) (parallel citations omitted)

produced a result without a sound analytical basis on either ground. Moreover, it has generated conflict and confusion among State courts and threatens to stymie a variety of efforts to establish a more balanced system for taxing the business of insurance.

I. The court of appeals' decision, following *Todd Shipyards*, conflicts with this Court's Due Process jurisprudence in State tax cases.

The Court's view of constitutional limitations on State taxation has changed over the years. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) (examining the practical effect of a tax to determine its constitutionality under the Commerce Clause). *Complete Auto* did away with the formalistic rule that prohibited State taxation of interstate commerce if "the incidence of the tax is the 'privilege of doing business.'" *Id.* at 278 (*disapproving Spector Motor Serv. v. O'Connor*, 340 U.S. 602 (1951)). "There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." *Id.* at 288. In doing away with the *Spector* rule, the Court announced a new rule for all future Commerce Clause tax cases and "moved toward a standard of permissibility of state taxation based upon its actual effect." *Id.* at 281. This case does not involve the Commerce Clause, but it does involve the same retreat into formalism and disregard of economic reality that this Court has consistently opposed in testing the constitutional limits of State taxation.

State taxing authority is, and will always be, limited by the fundamental concerns of constitutional Due Process. The Court's views of Due Process, like its views of the Commerce Clause, have changed over the years. *See, e.g., Shaffer v. Heitner*, 433 U.S. 186, 196-212 (1977) (reviewing and rejecting the Due Process jurisdictional reasoning of *Pennoyer v. Neff*, 95 U.S. 714

(1878)). In this case, the court of appeals disregarded those evolving views and opted to retain a formalism rejected elsewhere. State taxation of insurance should be measured by the same practical and rational standards that apply to taxation of every other kind of value, but only this Court can assure that it will.

Because few, if any, cases specifically discuss the Due Process principles applying to the taxation of insurance, it may be helpful to consider those principles in other tax contexts. The Court's most recent decisions on Due Process in taxation reaffirm that Due Process requires the value subjected to tax to be rationally connected to the taxing State. *See Hunt Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S. 458 (2000). This question often arises when a State seeks to tax the "unitary" income of a non-domiciliary corporation doing business both inside and outside the State. *Id.* at 460. Courts must inquire whether "there is a minimal connection or nexus between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise" in order "to tax income arising out of interstate activities." *Id.* at 464 (internal citations and quotation marks omitted). If these are lacking, the "nonunitary" income may only be taxed by the corporation's domiciliary State, unless there is some other connection between the taxing State and the income. *Id.*

Unlike the hypothetical Illinois tin can manufacturer and the New Zealand sheep farming subsidiary in *Hunt Wesson*, Dow Chemical pays premiums that are directly related to its business activities in Texas rather than as part of an unrelated and discreet business enterprise. *Cf. Allied Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778-82 (1992) (intangible asset was not attributable to activities within the taxing State). This closely connected value is why States generally tax insurance premiums based on location of the risk. The Court should reaffirm that the source of taxable value is meaningful to an inquiry on the Due

Process limits of taxation. Intrastate activities, such as negotiating and paying for insurance, that are unrelated to generating value to the insured should not control.

In *Quill*, this Court announced that "we have abandoned more formalistic tests" for Due Process. *Quill Corp. v. North Dakota*, 504 U.S. 298, 307 (1992). "[O]ur modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection." *Allied Signal*, 504 U.S. at 778. The court of appeals' decision in this case, doggedly following *Todd Shipyards* and ignoring the teachings of *Hunt Wesson* and *Quill*, reinvigorates the Due Process formalism of another era. The court determined that "a due-process analysis is unnecessary" and declined to consider whether *Quill*'s rejection of formalisms, such as a physical presence requirement for Due Process, should also apply to the insurance tax in this case. *Dow Chem.*, 38 S.W.3d at 746.

Instead of looking to practical economic realities, the court of appeals relied on the *Todd Shipyards* laundry list of contacts between Texas and Dow Chemical's insurers. *Id.* While these contacts would surely be relevant to a tax assessed against the insurers, the State is not taxing them. Dow Chemical, of course, has nexus with Texas. In this case the State taxes Dow Chemical on its insurance rather than its income. The activities and contacts of insurers in the taxing State form a Due Process basis to tax the properly allocated or apportioned value of the premiums they receive. The same activities and contacts that generate this income stream to insurers, however, have little or no real economic connection to the value of Dow Chemical's insurance to Dow Chemical.

"[A]rriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). The task is not difficult in this case. Insurance taxes generally allocate

premiums for tax purposes according to the location of the risk. It is undisputed that the premiums taxed in this case were properly allocated to Texas. An insurance tax based on location of the risk satisfies the Due Process requirement that the tax base "must be rationally related to values connected with the taxing State;" otherwise, this widely accepted method of allocating taxable value may be unconstitutional. *Quill*, 504 U.S. at 306 (internal quotations and citation omitted).

The rationale for taxing an insurance consumer on this basis should be evident. The value of insurance to an insured does not arise out of its "activities" in obtaining the insurance. The substantial premiums paid by Dow Chemical, on which tax was imposed, arise out of Dow Chemical's substantial property and business interests in Texas that the insurance was bought to protect. Dow Chemical's insurance has value, not because premiums were negotiated and paid from its Michigan headquarters or because many of the policies were placed with Bermuda insurers, but because the premiums protect its substantial property and business in Texas.

An income tax may reach income from intangible assets, if the intangible value has an operational rather than merely an investment function. *Allied Signal*, 504 U.S. at 787. Assuming that a similar Due Process test applies to a tax on the value of insurance to an insured, it should also be obvious here that Dow Chemical's substantial insurance coverage is not some investment to be bought and sold. Instead, it is intimately connected with Dow Chemical's substantial business operations in Texas.

The Court has also considered problems of geographic allocation of taxable value for other taxes, such as the value added tax. "We can accept the premise that apportionment is permitted only when precise geographic measurement is not feasible, for to allow apportionment where there is no practical or theoretical

justification could provide the opportunity for a State to export tax burdens and import tax revenues." *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 374 (1991). *Trinova* held that the three-part tax base in Michigan's single business tax was rationally allocated and apportioned. *Id.* at 376-82, 387. The key, as usual, was whether the values taxed by the State had some theoretical and practical source in the State. The factors to look at in making that decision should be those "*by which value is generated.*" *Id.* at 381 (emphasis original) (quoting *Container Corp.*, 463 U.S. at 183 (emphasis added)).

In this case, taxable value was allocated to Texas under the well established and widely accepted method of location of the risk. The Texas property and business interests that Dow Chemical protects with its insurance are inextricably connected with Texas. Insurers doing business in Texas pay Texas tax on Texas risk because it is an obviously rational measure of the value of business they do in the State. Dow Chemical should pay tax on its insurance covering Texas risks because its real economic value is just as inextricably connected with Texas as the property and business interests that Dow Chemical has insured. The practical and theoretical Due Process justification for allocating this value for the insured is just as sound as it is for the insurer.

The tax in this case is similar to the commonly accepted "use" tax, in which tax is imposed on the rights of ownership of a purchased item rather than the sales transaction itself. *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Rather than purchasing physical property for use in Texas, Dow Chemical has purchased an important set of intangible rights protecting its substantial property and business interests in Texas. Of course, Dow Chemical and all concerned hope that it will not have to "use" its insurance, but the intangible value is real. A "use" tax ordinarily would have to meet the stricter test applying to compensatory taxes on goods or other intangibles because of the

dormant or negative restrictions of the Commerce Clause. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 333-34 (1996). Even though the McCarran-Ferguson Act eliminates that test for this tax, the test could be met because the rate is the same for similar insurance transactions and business occurring within the State as it was for Dow Chemical in this case. *See Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 653-54 (1981). TEX. INS. CODE §101.251, art. 1.14-2 §12(a).

The State taxed Dow Chemical initially on "the obligation, chose in action, or right represented by the premium charged for [independently procured] insurance." Act of May 12, 1967, 60th Leg., R.S., ch. 185, §1 (former TEX. INS. CODE art. 1.14-1 §12(c) *amended by* Act of May 18, 1995, 74th Leg., R.S., ch. 279, §1). The standards for taxing intangible value have not been immutable, but the Court has long recognized that States may tax the intangible values of corporations and that "the Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation." *Pacific Express Co. v. Seibert*, 142 U.S. 339, 351 (1892). The Court has even recognized that, because it will often be difficult to establish an exclusive taxable situs for intangible value, intangibles may be subject to tax in more than one State. *State Tax Comm'n v. Aldrich*, 316 U.S. 174, 179-80 (1942). Little or no threat of overlapping taxes exists in this case, because the location of the risk rule allocates value geographically in a way that is often not feasible for other intangible values.

According to the court of appeals, however, *Todd Shipyards* prohibits the tax in this case even though it otherwise comports with Due Process. *Dow Chem.*, 38 S.W. 3d at 747. *Todd Shipyards* is the direct descendant of *St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 346 (1922). That case, following *Allgeyer* and the *Child Labor Tax Case*, held that the State's tax on a consumer of insurance was actually a prohibition that, in turn, violated the Due Process Clause. 260 U.S. at 348

(citing *Allgeyer v. Lousiana*, 165 U.S. 578 (1897) *and Bailey v. Drexel Furniture Co.*, 259 U.S. 20 (1922) (*The Child Labor Tax Case*)). In accordance with the wisdom of the time, the Court evidently saw the tax in *St. Louis Cotton Compress* as an improper exercise of regulatory police power rather than a true exercise of the taxing power. "The short question is whether this so-called tax is saved because of the name given to it by the statute." *St. Louis Cotton Compress*, 260 U.S. at 348. "[T]he State may regulate the activities of foreign corporations within the State but it cannot regulate or interfere with what they do outside." *Id.* at 349.

Texas does not prohibit Dow Chemical's procurement of insurance from out-of-state insurers. Texas does not attempt to regulate Dow Chemical's extraterritorial insurance activities any more than it would seek to apply its deceptive trade practice or licensing laws to an out-of-state vendor when collecting use tax from a corporation doing business in the State. On the contrary, Texas recognizes that such transactions may take place and exempts the non-admitted insurer from Texas regulation over its insurance business if the insurance consumer pays the independently procured insurance tax. TEX. INS. CODE §101.053(b)(4). This "so-called tax" is just a tax. *St. Louis Cotton Compress*, 260 U.S. at 348. No theory has been articulated as to why the independently procured insurance tax would fail today's constitutional Due Process test for taxation.

The fundamental Due Process question remains "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Texas benefits Dow Chemical by providing services and protections directly related to the risks that Dow Chemical has insured against. The capable workforce, sound

infrastructure, and safety and emergency services provided to Dow Chemical in Texas are more than enough to justify the independently procured insurance tax under the standards of Due Process.

Moreover, it is odd that the *Todd Shipyards* and *Dow Chemical* Courts gave no greater weight to the fact that both Todd Shipyards and Dow Chemical did substantial business within the State where tax was imposed and were given the same rights as are given to the State's domestic corporations. The ordinary rule is that corporations domiciled in other States but doing business within the State must be given equal treatment. *See, e.g., WHYY, Inc. v. Glassboro*, 393 U.S. 117 (1968). A State may discriminate against its own residents, but there should be some rational basis for doing so. *See Allied Stores of Ohio, Inc., v. Bowers*, 358 U.S. 522 (1959). As with the use tax, the independently procured insurance tax is an effort to draw revenue directly or indirectly from all insurance consumers, not just those who buy their policies locally. To impose discrimination by prohibiting taxation of this localized value furthers no valid practical or constitutional theory of State taxation.

Arguably, an unspoken tax theory of *St. Louis Cotton Compress* may be that insurance is taxable only at the place of contract or the domicile of the insured. *See Hanover Fire Ins. Co. v. Harding*, 272 U.S. 494, 507-08 (1926) (characterizing *St. Louis Cotton Compress* as a case involving attempted taxation of property outside the State) *and Aldrich*, 316 U.S. at 178-80 (discussing the theory behind taxing intangibles). If so, that theory is misapplied to insurance taxation here because a rational geographic allocation of the intangible value can be made. If that common method of value allocation cannot be used, then could the insured's domiciliary State tax the whole of the intangible value, as with "nonunitary" income? *See Hunt Wesson*, 528 U.S. at 464. Could the State where the insurance is negotiated and paid, or

where the physical policy is found, tax the whole value? *See Curry v. McCanless*, 307 U.S. 357, 366-70 (1939) (discussing taxation of intangibles). The intangible value of insurance is extremely important to virtually every business and to every State. The Court should articulate the Due Process principles by which the value in this case may be constitutionally taxed.

II. The court of appeals' interpretation of the McCarran-Ferguson Act conflicts with this Court's jurisprudence construing that Act.

Few federal statutes are more significant to the States than the McCarran-Ferguson Act. If *Todd Shipyards* is in fact a case construing the McCarran-Ferguson Act, then it is at odds with the plain language of the Act and with this Court's subsequent decisions construing it. "[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *United States v. Fabe*, 508 U.S. 491, 500 (1996). The Act should not be read "to 'turn back the clock' to a time prior to *South-Eastern Underwriters*." *Id.* at 506. *See United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). "[I]t is impossible to compare our present world to the one that existed at a time when the business of insurance was believed to be beyond the reach of Congress' power under the Commerce Clause." *Id.* at 508.

The court of appeals in this case, apparently stymied by *Todd Shipyards*, has turned the clock back forty years to *Todd Shipyards* and to a world that existed forty years before that. This approach to the construction of the McCarran-Ferguson Act may tempt other courts to "turn back the clock" and also bolsters a theory of statutory construction that looks to policy intimations in legislative history rather than the plain language of statutes to determine their meaning. "Obviously Congress' purpose was

broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429 (1946). The circumstances surrounding the enactment of the McCarran-Ferguson Act show that Congress intended to protect state insurance laws from *inadvertent* federal intrusion. *Barnett Bank v. Nelson*, 517 U.S. 25, 39-41 (1996) (emphasis original). It would be a great irony if Congress' Act "to restore the supremacy of the States in the realm of insurance regulation" *inadvertently* limited State authority through the same Act's legislative history. *Id.* at 40 (quoting *Fabe*, 508 U.S. at 500). The plain meaning of the language of the Act shows Congress' intent, and that plainly expressed intent should prevail in this case as it does elsewhere.

One oddity in *Todd Shipyards*, and a chief difficulty for State courts dealing with the case since its decision, is its reference to the legislative history of the McCarran-Ferguson Act and three of this Court's Due Process decisions. *Todd Shipyards*, 370 U.S. 453 (citing *Allgeyer v. Lousiana*, 165 U.S. 578 (1897); *St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 346 (1922); and *Connecticut Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77 (1938) (collectively the Trilogy); H.R. Rep. No. 79-143 at 3 (1945); 15 U.S.C. §§1011-1015.

This Court generally has not been eager to overlook the plain language of a statute and defer to its legislative history in order to determine the meaning and intent of the statute. *See W. Virginia Univ. Hosp., Inc. v. Casey*, 499 U.S. 83, 98-101 (1991). *See also Circuit City Stores, Inc. v. Adams*, 121 S.Ct. 1302, 1310-11 (2001) (following the plain language of the Federal Arbitration Act despite contrary historical and policy arguments.) The McCarran-Ferguson Act says plainly "that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the

regulation or taxation of such business by the several States." 15 U.S.C. §1011. "The business of insurance...shall be subject to the laws of the several States which relate to the regulation or taxation of such business." 15 U.S.C. §1012(a).

The *Todd Shipyards* Court, however, read the reference to the Trilogy in McCarran-Ferguson's legislative history as Congress' "indicat[ion] without ambiguity . that such state 'regulation or taxation' should be kept within the limits set by the *Allgeyer*, *St. Louis Cotton Compress*, and *Connecticut Gen. Life Ins.* decisions." *Todd Shipyards*, 370 U.S. at 456. "Since these earlier decisions are part of the arch on which the new structure rests, we refrain from disturbing them lest we change the design that Congress fashioned." *Id.* at 458. *Todd Shipyards* did not honor Congress' intent by overlooking "the bare bones of the McCarran-Ferguson Act" and deferring instead to its legislative history. 370 U.S. at 453. Worse, the Court also misjudged the significance and meaning of that history.

The legislative history of the McCarran-Ferguson Act merely states the truism that "the continued regulation and taxation of insurance by the States [shall be] subject always...to the limitations set out in the controlling decisions of the United States Supreme Court as, *for instance*, ...[the Trilogy]." H.R. Rep. No. 79-143 at 3 (1945) (emphasis added). The McCarran-Ferguson Act "was so designed as not to displace those three decisions." 370 U.S. at 455. But the legislative history does not indicate, conversely, that Congress intended to enshrine them. Congress intended only to displace certain effects of this Court's decision in *South-Eastern Underwriters*. *See South-Eastern Underwriters*, 322 U.S. at 552-53 (holding that the business of insurance is subject to Congress' authority under the Commerce Clause). *See also Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 880 n.8 (1985) (the Act was Congress' response only to *South-Eastern Underwriters*).

"[W]e give to the States no more powers than those they previously had, *and we take none from them*." *See Todd Shipyards*, 370 U.S. at 456 (quoting Sen. McCarran, 91 CONG. REC. at 1442) (emphasis added). States were simply given back their pre-*South-Eastern Underwriters* authority without additions or restrictions. 91 CONG. REC. 481, 483 (1945) (statements of Sen. Ferguson). Congress based the McCarran-Ferguson Act on draft legislation provided by the NAIC and acted promptly to cure the "absolute chaos exist[ing] in the insurance world." *Id.* at 483-84 (statements of Sens. O'Mahoney and Ferguson). Congress, with the support of the NAIC, did not intend State authority over the business of insurance to be forever defined by the authority that existed in 1945. *See also State Oil Co. v. Kahn*, 522 U.S. 3, 20-21 (1997) (Sherman Act invoked the common law itself, not merely the static content of the law as it existed in 1890).

By characterizing *Todd Shipyards* as a case construing the McCarran-Ferguson Act, the court of appeals reintroduces the same "turn back the clock" approach that this Court rejected in *Fabe*. It also presumes, ironically, that Congress intended, in a House Committee Report, to restrict the States by referring to a few Due Process decisions of this Court, while, in the plain language of the Act, Congress intended to liberate and restore them to the full authority they previously had. *Cf. Western & Southern*, 451 U.S. at 655 n.6 (rejecting the argument that the Act altered standards other than those derived from the Commerce Clause). The McCarran-Ferguson Act should be read to leave the States free to exercise their authority over the business of insurance, subject only to the constitutional standards of this Court and to the legislation of Congress on the subject of insurance. Instead, if *Todd Shipyards* means what the court of appeals said it does, the States are shackled to the past by a gossamer chain forged from a strand of legislative history.

III. *Todd Shipyards* has created conflict and confusion among the State courts seeking to apply it, and it ought to be explicitly overruled.

State courts are in conflict over the validity and meaning of *Todd Shipyards*, and only this Court can resolve it. *Compare Dow Chem.*, 38 S.W.3d at 745 *with Associated Elec. & Gas Ins. Serv. v. Clark*, 676 A.2d 1357, 1361 (R.I. 1996). The court of appeals in this case determined that *Todd Shipyards* "held that Texas' independently procured insurance tax violated McCarran-Ferguson." *Dow Chem.*, 38 S.W.3d at 745. The Rhode Island Supreme Court has stated plainly that "the holding in *Todd Shipyards Corp.* has been superseded not only by the state cases that purported to distinguish it but more significantly by the clear holding in *Quill*. We no longer exalt form over substance." *Associated Elec.*, 676 A.2d at 1361. *See also Lakehead Pipe Line Co., Inc. v. Amer. Home Assurance Co.*, 981 F. Supp. 1205, 1214-15 (D. Minn. 1997) (citing *Todd Shipyards* but declining to hold that a bond requirement violated Due Process for an insurer whose only contact with the State was the insured property).

State courts have not even been able to agree whether *Todd Shipyards* is a case based on Due Process, motivated by *stare decisis*, or a case construing the McCarran-Ferguson Act. *Compare, e.g., Associated Elec.*, 676 A.2d at 1361; *Howell v. Rosecliff Realty Co.*, 245 A.2d 318, 324 (N.J. 1968) (*Todd Shipyards* did no more than place the precise holdings of those cases beyond reconsideration); *Ministers Life & Cas. Union v. Haase*, 141 N.W.2d 287, 291-92 (Wis. 1966) (*Todd Shipyards* defined outer limits of due process but did not freeze state regulation to the type then extant) *appeal dismissed for want of a substantial federal question*, 385 U.S. 205 (1967); *and Gage & Tucker v. Dir. of Revenue*, 769 S.W.2d 119, 126 (Mo. 1989) (tax did not violate due process); *with Dow Chem.*, 38 S.W. 3d at 745; *People v. United Nat'l Life Ins. Co.*, 427 P.2d 199, 203 (Cal.)

(state regulations should be examined in the light of due process criteria existing prior to the enactment of the McCarran Act) *appeal dismissed for want of a substantial federal question*, 389 U.S. 330 (1967) *In re Markel Ins. Cos.*, 724 A.2d 848, 856 (N.J. Super. 1999) (*Todd Shipyards* ruled that Congress did not intend for states to have power to tax insurance transactions whose significant incidents occur wholly outside the state); *and Armed Forces Coop. Ins. Assoc. v. Dep't of Ins.*, 622 P.2d 1318, 1338-44 (Wyo. 1980) (Congress intended to impose limits of the Trilogy).

Some of these courts described the obvious interests and connections that States have regarding the insurance covering risks in those States. Insurance is an essential part of a State's primary responsibility. "[T]he State's power should not depend upon where the parties choose to contract for the insurance or to pay the loss." *Rosecliff Realty*, 245 A.2d at 324. The New Jersey court also recognized that parties to the insurance transaction are "aided by the measures the State takes to limit the incidence of losses covered by insurance." *Id.* Despite the limitations imposed by *Todd Shipyards*, the court opined that "there should be no need to find additional contacts or activities within a State to enable the State to act." *Id.*

The Wyoming Supreme Court has expressed similar views. "We think that a tax imposed by Wyoming on gross Wyoming premium receipts is constitutionally fair. The Wyoming insurance premiums bear a special and obvious relationship to Wyoming." *Armed Forces Coop.*, 622 P.2d at 1347. The court also noted the obvious relationship between the benefits and services provided in the State and the real economic interests represented by the insurance. "The cost of the insurance...will naturally depend on the occurrence or non-occurrence of disasters or mishaps in Wyoming. The frequency of such disasters or mishaps will, in part, be determined by the efforts of Wyoming in preventing them." *Id.* The court concluded that the real economic

consequence of the insurance in Wyoming "will depend on the protections Wyoming affords to [the] Wyoming insureds." *Id.*

Under *Todd Shipyards*, and if the taxpayer's domicile is the controlling factor in allocating the taxable intangible value of insurance, a Texas corporation, no matter how small, presumably may be liable for taxes on its procurement of insurance outside of the State under the circumstances of this case. A foreign corporation authorized to do business in a State, no matter how substantial its operations and insurance coverages, would be exempt from payment of tax on its purchases of independently procured insurance under the same circumstances. But if some correspondence or money is exchanged within the State, then the tax may be applied. *See, e.g., Ministers Life*, 141 N.W. 2d at 354; *People v. United Nat'l*, 427 P.2d at 207. An agent or adjuster investigating a claim in the State may justify the tax. *Rosecliff Realty Co.*, 245 A.2d at 327.

One could reasonably expect that Dow Chemical's insurers would send agents or adjusters to Texas if Texas were again struck by a major hurricane. The State's authority to collect tax on the localized value of an intangible asset owned by a corporation doing business in the State should not depend on a devastating and capricious windfall. If Dow Chemical negotiated its insurance from Freeport, Texas, rather than Midland, Michigan, would the practical economic connection between Texas and the value of the insurance be any different or any greater? If insurance negotiations and contract activities occur in more than one jurisdiction, what standards may be used to allocate or apportion the taxable value of the insurance? The *Todd Shipyards* rule makes no constitutional or practical economic sense.

Whether viewed as a decision on Due Process or one construing the McCarran-Ferguson Act, *Todd Shipyards* is in conflict with the Court's more recent jurisprudence. Unless this

Court resolves the conflicting and confusing doctrine of *Todd Shipyards*, States will not even know whether they should apply to Congress or await further action by this Court to overcome the anomalous and arbitrary results of this case. One State that in the past had not imposed insurance tax according to the location of the risk has recently amended its laws to do so. *See City of Charleston v. GEICO*, 512 S.E.2d 504, 506 (S.C. 1999). Should States now revert to a place of contract or domicile theory for taxing insurance? Should the NAIC's Model Act on nonadmitted insurance specify that corporations doing business in a State are outside the definition of "[e]ach insured in this state" for purposes of the independently procured insurance provision? *See* NAIC Model Act V-870-1 §6.

If *Todd Shipyards* is a case founded on Due Process, then it perpetuates outdated, formalistic concepts of Due Process, such as the place of contract, that say nothing about the fair taxation of the real economic value of insurance. Overruling *Todd Shipyards* will end that formalism and make insurance taxes, like all others, depend on Due Process nexus over the taxpayer and on taxation of values rationally connected to the taxing State.

If *Todd Shipyards* is a case construing the McCarran-Ferguson Act, then it inadvertently intrudes on the authority of States over the existing and future taxation of insurance that Congress specifically intended to protect. Overruling *Todd Shipyards* will end that intrusion. It will assure and effectuate Congress' intent to make State authority over the business of insurance, now and in the future, subject to Congress' express legislation on insurance and "to the controlling decisions of the United States Supreme Court." H.R. Rep. No. 79-143 (1945).

CONCLUSION

For the reasons stated, this petition for writ of certiorari should be granted.